

Energy Highs Capture Attention of Capital Markets

By Del Torkelson

HOUSTON—While oil and natural gas generate most of the energy in today's world, capital investment stands as the "resource behind the resource." In an era where energy demand has driven commodity prices to historic highs, a corresponding demand also has arisen for the money needed to fuel new oil and gas exploration, drilling and production activity.

And while U.S. oil and gas companies have endured long periods where the general investment community's attitude toward them has been chilly at best, the increasingly hot commodity prices of recent years have spurred an undeniable thaw. The flow of capital to finance oil and gas projects and companies has swelled from a trickle to a stream to a flood.

The capital products that operators now find available to them fill a wide landscape of deal sizes and risk appetite. New sources of traditional bank debt, mezzanine loans and private equity are creating a buyer's market for seekers of oil and gas capital. Recognizing this stiff competition among oil and gas investors, more financial resources are ready to listen to a broader range of deals.

While some of the new dollars finding their way into the industry are passing through some correspondingly new hands, a number of financiers with longer oil patch histories are looking to make the most of the good times by upping their antes with more dollars and new capital products.

New Era?

Bainbridge Capital Director Nick Chini insists that understanding the firm's energy approach means taking in the global energy picture. In that scenario, populous developing countries such as China and India are ravenous for energy while the North American and Western European economies also continue to grow. Meanwhile, he says, mounting evidence points to peaking world oil production.

"This market is unlike any previous environment the energy sector has ever seen," he asserts. "This time, the supply side curve is not manageable. *The Economist*, the geophysicists at MIT, the international banks, and the International Monetary Fund have all built this into their models.

"When T. Boone Pickens says he sees a completely different supply and demand curve for the first time in his ca-

changing how we do acquisitions for our clients, as well as how we do investments for our own fund. There is a new class and breed of investor in there, and there is also a new breed and class of operator who will emerge in the next 10 years."

With that in mind, Chini says Bainbridge is seeking long-term, quality growth opportunities for its clients while also raising \$850 million for its second private equity fund. "Our fund will do deals between \$10 million and \$175 million," he observes. "Our target range is \$65 million. This year we will do some transactions that are easily above that, and there are really good, strategic acquisitions of \$5 million-\$7 million plays with good geography and geology that are maybe entering secondary and tertiary recovery, or are really good existing production."

The industry is also starting to see some new investors that were not interested in

"Operators and investors are going to have to have more fortitude if they are drilling new holes," he forecasts.

Partially because it does not involve drilling new holes, one pursuit that Bainbridge expects to characterize the next decade of the U.S. oil industry is secondary and tertiary enhanced oil recovery, Chini reveals. "We are looking at a 45-80 percent increase in capital requirements to do the kind of development an operator would have done 10 years ago," he evaluates. "Even if we went back to \$40-\$45 a barrel oil, some of the new technology is making it possible to go back and tap assets that didn't make sense to tap 5-10 years ago. But the only possibility of us going below \$50 is a catastrophic geopolitical event that would temporarily cut demand."

Not all of the EOR technology is new, Chini says, pointing out that techniques making use of carbon dioxide, surfactants and polymers have been on the shelf for 20 years. "Now these technologies make economic sense and their efficacy has seen at least incremental improvement," he says.

To that end, Bainbridge has clients that will buy mature oil assets in less than 60 days, depending on the field, location and percentage of gas versus oil. "We are finding these assets for them," he illustrates. "We close without the auction process, without the time-consuming elements of creating and having them shop a data room. We also pay a very good price, often with currency other than cash only. Some of our clients use stock or equity currency. We have other ways to reward sellers and maximize their total return, given capital gains and tax liability."

Chini says many Bainbridge clients prefer privately negotiated transactions that allow buyer and seller to work across the table toward a mutually beneficial outcome. "There are so many buyers going to auctions, you have to have the highest price and then some," he says. "If you are a seller, you can consider privately negotiated transactions a private auction that allows an opportunity to promote your company specifically to the buyer. You can identify and work with the buyer to come up with the synergies and the positive attributes of a marriage between the two companies. Privately brokered deals provide a venue that is lower stress, more straightforward, transparent, and quicker."

Furthermore, he adds, because private sales generally involve a company's president and chief executive officer, the parties deal directly with the decision maker. "It is a chance to tell your story—and a better story at that—to the person who is making the purchasing decisions," he reasons. "That is how you extract an extra \$5 million-\$10 million out of a \$100 million-\$120 million deal—work with the buyer." □

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NICK CHINI
Director, Bainbridge Capital

reer, when the Organization of Petroleum Exporting Countries no longer has the supply side control it once did, and when countries such as China and India emerge in the demand factor, you know that the economics and investment strategies have changed permanently," Chini holds. "Energy is in a new era."

In its attempts to map the uncharted waters for its investment banking, buy- and sell-side acquisition and divestitures clients, and recapitalization and private equity business, Bainbridge is convinced that even \$60 a barrel oil prices will prove more of a step than summit, Chini reveals. "If you look at the next seven years, we are not at a price peak," he maintains. "Even two years from now we could easily look back and conclude we are not at a price peak."

Chini says major oil companies provide strong evidence to support that thesis when they return to plays left dormant for decades. "These plays will not yield a return for another five years," he indicates. "The majors have built into their production and investment plans a five-year price at roughly where we are now. Look very carefully at what the majors are doing."

In light of such facts, Chini says Bainbridge has adopted a long-term approach to investing in, developing and growing the energy sector. "This requires a new investment paradigm," he imparts. "That is

oil and gas only eight years ago, he adds. "On the institutional side, we are seeing a lot of activity that we did not see three-four years ago with investors that have a longer time horizon," he reveals. "That is what we look for. We are ultimately a management firm. We are about management and operations; we are not just about financing and flipping deals. This is about long-term growth, investment, development, building asset value, and building companies through roll-ups."

Corporate clients that approach Bainbridge for M&A assistance are essentially looking to beat the market at its own game by playing with high quality, proprietary transactions, Chini says, adding that it was the firm's experience in that field that prompted it to expand into other areas.

"Our activity with private equity and some of the proprietary deals we are doing all arose because of our M&A work," he relates. "We saw a need. We had private equity and institutional investors with whom we were already working in other industries. It made perfect sense. We knew the market and were able to bring in investors that did not know the market as well as we do."

North American EOR

Chini predicts that robust drilling activity will translate into higher project failure rates during the next 10 years.